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TREASURY FOR DAN PETERS

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TAGS: EAID EFIN ECON PREL UG
SUBJECT: The Global Financial Crisis and Uganda: Safe for Now, But Global Recession Will Hurt Later

¶1. (SBU) Summary: Economists and bankers in Uganda believe the global financial crisis will have little impact on economic growth this year, but could lead to slower growth over the medium term if the crisis results in a global recession. Should the latter unfold, Uganda's economy would be vulnerable to reduced flows of donor assistance, remittances, and foreign direct investment. It would also be hit by lower prices for critical exports and higher interest rates for government and businesses. On the upside, however, Uganda's economy remains generally well-insulated from the international credit crunch because the Government of Uganda (GOU) has kept debt ratios low, and because domestic banks have little exposure to international markets. End Summary.

CONCERNS OVER MEDIUM-TERM VULNERABILITIES

¶2. (SBU) Michael Olupot Tukei, Assistant Commissioner of Macroeconomic Policy at the Ministry of Finance, told Econoff that the global financial crisis is not expected to impact growth this year but that 2009 growth levels could fall "marginally," between 0.5 and 1 percentage point. He said Uganda is not re-evaluating its economic forecasts at this time, however, due to the uncertainty of the depth of the crisis and because the economy is also expected to benefit from Uganda's recent discovery of oil and other indigenous factors such as the recent stability and development of northern Uganda, a boom in construction, and a recent expansion of regional trade to southern Sudan due to improved security conditions there.

¶3. (SBU) In contrast, Abebe Selassie, the International Monetary Fund Resident Representative in Uganda, agrees that it will take a bit of time for the effects of the crisis to materialize, but that Uganda has several sources of medium-term vulnerability:

-- Official Donor Assistance: Selassie said donors in 2008-2009 funded 32 percent of the Ugandan budget with direct budgetary support, while other donors such as the United States provide hundreds of millions of dollars in off-budget support. Both Selassie and Finance Ministry Economist Tukei expect foreign donors to cut aid budgets in the event of a world-wide recession. While assistance for the current 2008-2009 fiscal year has been allocated already, the impacts on the 2009-2010 budget could be significant.

-- Less Foreign Investment and Increased Borrowing Costs: Nonresident players such as hedge funds, private equity investors, and pension funds currently own about $300 million in Ugandan government securities. Heavily leveraged hedge funds in particular may have to liquidate assets and have already sold $20-30 million in Ugandan treasury bills, about 8-10 percent of the total stock. However, Selassie said, the Bank of Uganda (BOU) remains sanguine about these sales, as BOU foreign currency reserves, at about $2.7

billion, or six months of import coverage, remain healthy. "Capital flight at this level is affordable -- even if all of the $30 million left in a day," Selassie said. Still, he noted, with less liquidity available worldwide, Uganda can expect smaller foreign investment inflows, which may hit growth and hamper development. The mass sale of Ugandan treasury bills by foreign investors could also make borrowing more expensive for the government and businesses. Bankers state that higher interest rates are already being passed on to businesses, a fact which could harm investment over the longer term. Interest rates for prime borrowers had already risen by about one percentage point, Selassie said.

-- Exchange rate vulnerability: The Ugandan Schilling (UGSh) fell to 1705 to the dollar on October 14, down almost 9% from quoted rates in September. Citibank Managing Director Shirish Bhide told Econoff that a combination of portfolio sales of Ugandan treasury bills and the halting of fresh dollar inflows from portfolios had caused the weakening. While the decline may help exports, more costly of imports will hurt Uganda's developing economy, which relies heavily on imports for infrastructure development.

-- Commodity prices: Should commodity prices plummet and world growth slow, then revenues from key Ugandan exports such as coffee will be hit. While such a commodities price reduction could be neutral for Uganda's balance of payments (as the price of other commodities such as oil also falls), the impact on the agricultural sector will be disproportionately large, Selassie said. "In terms of poverty, the current high price of commodities is probably a good thing because the average coffee farmer depends less on fuel prices than does you or me living in the city," he said.

-- Remittance flows: Uganda currently receives some $500 million annually in private remittance flows, sent from Europe and the

United States by Ugandan workers. These flows will likely slow as workforces are cut worldwide.

ON THE UPSIDE

¶4. (SBU) Despite these vulnerabilities, bankers and economists note that Uganda remains generally well insulated from the current crisis, primarily because Ugandan banks do not fund operations from borrowing abroad, favoring local deposits instead. Only 5-10% of a typical Ugandan bank's liabilities come from investments or lending abroad. "Uganda should be ok. There's not too much connectivity with the rest of the world, but of course you can't put away the impacts of a long-term recession," said Citibank's Bhide. Insurance giant American Investment Group (AIG) also has little exposure to international markets, according to a company statement issued last week to reassure local policy holders.

¶5. (SBU) Another critical safeguard is Uganda's low level of foreign debt. At about 20 percent of GDP (compared to about 70 percent for the United States), the country is not nearly as reliant as many countries that have financed their deficits by borrowing on international markets.

¶6. (SBU) Comment: Entering its third decade of continued economic expansion, Uganda has received plaudits from international economists for its macroeconomic management. The benefits of these policies will be witnessed if borrowing costs rise, as Uganda does not borrow heavily on international markets. Ironically, though aid and trade could be hit over the medium term, Uganda's relatively low level of integration into international financial markets is currently protecting the country from the storm. In the longer term, however, realizing the advantages of globalization through greater foreign trade, foreign investment and external financing will remain critical to the country's longer-term development prospects. End Comment.
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